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No. 03-182

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IN THE

Supreme Court of the United States

SHALER AREA EDUCATION ASSOCIATION,
Petitioner,

v.

F. NAYLOR EMORY, DENNIS A. ERB,
ROBERT K. GILBERT, JAMES W. LOSSELL,
BARBARA J. MCALLEY, and WESLEY S. SEMPLE,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether, as the Third Circuit held in conflict with the Ninth Circuit, this Court's decision in *Chicago Teachers Union v. Hudson* invariably requires a small local union, as a precondition for collecting a statutorily authorized "fair-share" fee from nonmembers whom it represents in collective bargaining, to submit audited financial statements—regardless of the local's size and the complexity of its financial transactions, and even if the cost of conducting such an audit would far exceed the amount of fair-share fees at stake.

2. Whether, if audited financial statements are not invariably required, petitioner fulfilled its obligation under *Hudson* to give its fair-share feepayers "sufficient information to gauge the propriety of the union's fee" by providing a statement of the prior-year expenditures on which its fee calculation was based, broken down into chargeable and nonchargeable categories, along with the opportunity to inspect the union's ledger of itemized expenditures from which the categorical breakdown was derived.

PARTIES

In addition to petitioner Shaler Area Education Association, the defendants/appellants/cross-appellees in the court below included the Pennsylvania State Education Association and the National Education Association. In addition to the respondents listed in the caption, Marsha Otto was a plaintiff/appellee/cross-appellant in the court below.

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PETITION FOR WRIT OF CERTIORARI

Petitioner Shaler Area Education Association respectfully requests that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered on May 8, 2003, in *Otto v. Pennsylania State Education Ass'n*, 330 F.3d 125 (3d Cir. 2003).

OPINIONS BELOW

The amended opinion of the United States Court of Appeals for the Third Circuit is reported at 330 F.3d 125, and is reproduced in the Appendix to this Petition ("App.") at 1a. The order of the Third Circuit denying rehearing en banc and granting panel rehearing is reported at 328 F.3d 715, and is reproduced at App. 26a. The initial opinion of the Third

Circuit, subsequently withdrawn, is reproduced at App. 29a. The opinion of the United States District Court for the Middle District of Pennsylvania is reported at 107 F. Supp. 2d 615, and is reproduced at App. 55a. The report and recommendation of the magistrate judge is reported at 161 L.R.R.M. (BNA) 2036, and is reproduced at App. 76a.

JURISDICTION

The judgment of the United States Court of Appeals for the Third Circuit was initially entered on April 3, 2003. A timely petition for rehearing was granted, the judgment and opinion of April 3 withdrawn, and an amended opinion issued, on May 8, 2003. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION INVOLVED

The First Amendment to the United States Constitution provides in pertinent part that "Congress shall make no law . . . abridging the freedom of speech . . . ."

STATEMENT OF THE CASE

Petitioner Shaler Area Education Association ("SAEA") is a typical small public-sector local union. SAEA has 344 members and annual revenues of $22,000 derived entirely from dues and fees. The union has no employees but is governed and administered entirely by volunteer member-officers—full-time teachers employed in the bargaining unit—who are elected by their fellow members.

SAEA acts as the exclusive bargaining representative for 355 educators employed by the Shaler Area School District. As authorized by the Pennsylvania Public Employe Fair Share Fee Law, 71 Pa. Stat. Ann. § 575, the collective bargaining agreement between SAEA and the school district contains a provision pursuant to which bargaining-unit

educators who opt not to join the union are required to pay a fair-share fee (also called an "agency fee") to offset their pro rata share of the union's costs of representation.

In *Chicago Teachers Union v. Hudson*, 475 U.S. 292 (1986), this Court ruled that unions entitled to a fair-share fee must, as a first step in securing payment, provide the nonmember feepayers with "an adequate explanation of the basis for the fee." *Id.* at 310. SAEA and its state and national affiliates, the Pennsylvania State Education Association ("PSEA") and the National Education Association ("NEA"), annually send to each feepayer a "Notice to Fair Share Feepayers"—commonly referred to as the "*Hudson* notice." This notice sets out the amount of the fair-share fees assessed by SAEA, PSEA, and NEA, explains how each of the unions calculated that amount on the basis of its prior-year expenditures, and informs the feepayer of the procedures through which she can challenge the amount of the fee.[1]

The *Hudson* notice contains PSEA's and NEA's audited statements of their chargeable and nonchargeable expenditures for the previous school year. The notice also contains (i) SAEA's unaudited statement of its prior-year expenditures, broken down into eleven categories of chargeable and six categories of nonchargeable expenditures; (ii) SAEA's

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[1] This Court has held that the First Amendment prohibits unions from charging fair-share feepayers, over their objection, for the portion of union dues that goes for activities not germane to the union's collective bargaining function. *See generally Lehnert v. Ferris Faculty Ass'n*, 500 U.S. 507 (1991). SAEA, like other unions, therefore calculates its fair-share fee by determining which of its activities are chargeable and which are nonchargeable to objecting feepayers, and calculating the percentage of its prior-year expenditures that went for the former. That percentage, applied to the union's regular membership dues, yields the fair-share fee constitutionally chargeable to objecting nonmembers. (By statute, Pennsylvania limits the fair-share fee for *all* public-sector feepayers in a way that is roughly equivalent to the constitutional limitation for objectors. *See* 71 Pa. Stat. Ann. § 575(a).)

budget for the current year; and (iii) an invitation to SAEA feepayers to inspect SAEA's ledger of prior-year expenditures on which its fee calculation is based.

The plaintiffs-respondents were, during the 1994-95 and 1995-96 school years, SAEA-represented bargaining-unit educators but not members of the union. They brought this litigation as a class action under 42 U.S.C. § 1983 challenging the fair-share fees assessed by SAEA, PSEA, and NEA. In their complaint the plaintiffs alleged *inter alia* that SAEA's fair-share fee was unconstitutionally assessed because its *Hudson* notice did not contain an audited statement of SAEA's prior-year expenditures on which the fee calculation was based. The district court's jurisdiction was predicated on 28 U.S.C. §§ 1331 and 1343.

After the district court denied class certification, the parties agreed to a partial settlement that resolved all claims for damages, as well as all claims for declaratory and injunctive relief except with respect to three discrete legal questions, including the one at issue here. The parties also agreed to a stipulation of facts as the basis for litigating the three remaining issues on cross-motions for summary judgment. On July 3, 2000, Senior Judge Muir, adopting the recommendation of the magistrate judge, *see* App. 76a-90a, granted summary judgment in favor of plaintiffs on the issue presented here, holding "that the constitution requires Shaler Area Education Association to provide nonmembers a financial statement of its expenses that has been audited." App. 66a.

A panel of the Third Circuit affirmed this portion of the district court's judgment. App. 35a-42a. The court held "that every union collecting fair-share fees from non-members must subject its disclosed financial information to independent auditor verification," App. 38a, through "audits of their financial statements." App. 39a.

SAEA petitioned for rehearing, bringing to the Third Circuit's attention the intervening decision in *Harik v. California Teachers Ass'n*, 326 F.3d 1042 (9th Cir. 2003), *petition for cert. filed sub nom. Sheffield v. Aceves* (No. 03-89) (docketed July 16, 2003), in which the Ninth Circuit held that a small local union—one much like SAEA—was not required by *Hudson* to make its disclosure through audited financial statements to the exclusion of other alternatives.

Over the dissenting votes of Chief Judge Becker and Judge Nygaard, the full Third Circuit denied rehearing *en banc*. The panel, without changing the result, granted rehearing, vacated its previous opinion, and issued an amended opinion. App. 26a-28a.

In its revised opinion, the Third Circuit analyzed and stated its disagreement with the *Harik* decision, App. 8a-11a, explaining that while "something less rigorous for small local unions than independent auditor verification" might well be appropriate were it "writing on a clean slate," App. 11a, consideration of any such alternative was foreclosed by this Court's decision in *Hudson*. *Id.*

REASONS FOR GRANTING THE WRIT

In *Chicago Teachers Union v. Hudson*, 475 U.S. 292, 306 (1986), this Court held that a union that assesses members of a represented bargaining unit a fair-share fee must, in order to enable the feepayers to make an informed determination on whether to challenge the amount of the fee, provide them with "sufficient information to gauge the propriety of the union's fee."

In decisions only weeks apart, the Ninth Circuit—in *Harik v. California Teachers Ass'n*, 326 F.3d 1042 (9th Cir. 2003), *petition for cert. filed sub nom. Sheffield v. Aceves* (No. 03-89) (docketed July 16, 2003)—and the third Circuit, in the instant case, came to diametrically opposed answers to the

following question: Whether small local unions like SAEA—a local teachers' union with some 350 members and $22,000 in annual income—can *only* meet the *Hudson* disclosure requirement by providing feepayers with fully audited financial statements, and not in any other manner.

In *Harik*, the Ninth Circuit read *Hudson* to permit a small local union to "provide its feepayers with *either* the full financial material necessary to verify, *or* an independently sanctioned verification of, the local union's chargeable and non-chargeable expenditures," explaining that "providing financial reports along with full and fair access to bills, check stubs, canceled checks, account balances, and related materials may be more cost-efficient than an external review." 326 F.3d at 1049 (emphasis added).

In the instant case the Third Circuit held, to the contrary, that *Hudson* mandates that "local unions, regardless of their size, are required to obtain audits of their financial statements." App. 13a.

While the conflict between these Third and Ninth Circuit decisions is the most obvious manifestation of the lower courts' confusion over what *Hudson* requires, that is not the full extent of the division over this question. The two state appellate courts that have addressed the exact question presented here are similarly divided. *See Wareham Educ. Ass'n v. Labor Relations Comm'n*, 713 N.E.2d 363 (Mass. 1999); *Whitley County Teachers Ass'n v. Bauer*, 718 N.E.2d 1181, 1191-92 (Ind. Ct. App. 1999) (discussed *infra* pp. 12-13). And, in addressing a closely analogous question two circuits and one state appellate court have rejected the Third Circuit's reading of the *Hudson* disclosure requirement. *See Browne v. Wisconsin Employment Relations Comm'n*, 485 N.W.2d 376, 393-94 (Wis. 1992); *Thomas v. NLRB*, 213 F.3d 651 (D.C. Cir. 2000); *International Ass'n of Machinists v. NLRB*, 133 F.3d 1012, 1016-18 (7th Cir. 1998) (discussed *infra* pp. 13-15).

This is a conflict that only this Court can resolve and that urgently calls for this Court's attention.

First, the conflict among the lower courts has not been generated by differing views on whether audited financial statements are necessary to provide feepayers with proper disclosure or are otherwise required by the legal principles governing the agency fee system outlined in *Hudson*.

The conflict is, rather, the product of the lower courts' disagreement over how to read *Hudson*—specifically whether the *Hudson* Court's discussion of the disclosure requirement, 475 U.S. at 306-07 & n.18, is properly understood as an across-the-board mandate of audited financial statements in every circumstance.

Only this Court can state with authority what its *Hudson* opinion means in this regard. And, only this Court is entirely free to do so by focusing on the merits question of what kind of disclosure properly effectuates *Hudson*'s purpose of "devis[ing] a way of preventing compulsory subsidization of ideological activity by employees who object thereto without restricting the Union's ability to require every employee to contribute to the cost of collective-bargaining activities." *Id.* at 302.

Second, the question raised by this petition is one that has the most direct and serious impact on thousands of local unions.

The Third Circuit's decision threatens the ability of small local unions in Pennsylvania, New Jersey, and Delaware to collect any fair-share fee at all. As a result of the injunction entered by the trial court—which prohibits SAEA from collecting fair-share fees from plaintiffs without providing them with an independent auditor's verification of SAEA's calculation of those fees—SAEA has been forced to suspended collection of its fair-share fees.

The same is true of nearly all of the other local unions—the vast majority of which have fewer than 400 members—affiliated with the Pennsylvania State Education Association (which advised its affiliated locals to comply with the injunction's terms). Of PSEA's 603 locals that have bargained fair-share provisions, only 16 were able to obtain an audit and to collect their fair-share fees during the 2002-03 school year.

The hundreds of small local affiliates of other unions within the Third Circuit's jurisdiction will also be subject to the same constraint, if the decision here is not reviewed and reversed.

Beyond the jurisdictions covered by the Third Circuit's holding, small local unions in other jurisdictions will suffer from the legal uncertainty as to *Hudson*'s requirements created by the conflicting lower court decisions. The National Education Association alone has over 7,000 affiliated local unions of fewer than 400 members in the 19 states that have public-sector agency fee statutes. And NEA, of course, charters only a fraction of the local unions in the country entitled to negotiate fair-share provisions.

All of these local unions will be faced with a stark choice if this Court declines to clarify its *Hudson* opinion: the local can either acquiesce in the Third Circuit's holding and cease its collection of agency fees where the audit costs outrun the collectible fees; or the local can continue to proceed by making other forms of verifiable disclosure not involving an audit, at the risk of highly expensive litigation.

Given the lower courts' division on how to read the *Hudson* disclosure requirement, given the importance of that requirement in the effectuation of the overall agency fee system, and given the serious effect of the conflict on many thousands of local unions, the Court should grant review

to provide an authoritative answer to the question that has confounded the lower courts and that is presented by this petition.

I.

The constitutionality of legislation allowing a public-sector union to collect a fair-share fee from nonmember employees whom the union represents in collective bargaining is well established—as is the nonmember's First Amendment right to object to paying for political and other expenditures not germane to the union's collective bargaining function. *Abood v. Detroit Bd. of Educ.*, 431 U.S. 209 (1977); *Lehnert v. Ferris Faculty Ass'n*, 500 U.S. 507 (1991).

In *Hudson*, *supra*, this Court established certain prophylactic requirements intended to ensure that collection of the fair-share fee does not impair the nonmember's First Amendment right to refuse to pay for "nonchargeable" union expenditures. In particular, *Hudson* required that nonmembers "be given sufficient information to gauge the propriety of the union's fee," 475 U.S. at 306, in order to permit the nonmember to make an informed decision about whether to accept the union's calculation of its fair-share fee or to exercise her right under *Hudson* to challenge the fee before an independent decisionmaker.

In a footnote elaborating on this requirement the Court observed that the petitioner union there—a 27,000-member union with annual revenues exceeding $4.1 million—was not required to provide "an exhaustive and detailed list of all its expenditures," but that "adequate disclosure surely would include the major categories of expenses, as well as verification by an independent auditor." *Id.* at 307 n.18.

The question presented by this petition is whether *Hudson*'s requirement that unions disclose "sufficient information to gauge the propriety of the union's fee" requires a small

local union—like the 350-member SAEA with annual revenues of some $22,000—to provide its *Hudson* disclosure through audited financial statements.

Rather than obtaining an auditor's verification of its financial statements—at a cost of over $1,000, which would be more than twice the total of $495 due from its eleven nonmember feepayers, *see* App. 80a-81a—SAEA has attempted to fulfill its disclosure obligation under *Hudson* in two ways.

First, SAEA prepares from its ledger of itemized expenditures an unaudited breakdown of its actual prior-year expenditures in eleven categories of chargeable and six categories of nonchargeable activities, which it provides to its feepayers as part of its annual *Hudson* notice.[2]

Second, SAEA supplements this statement of its major categories of chargeable and nonchargeable expenditures by offering its feepayers the opportunity to inspect its ledger of itemized expenditures from which the categorical breakdown is derived and on which SAEA's fee calculation is based.

SAEA's contention is that, in the context of a small local union whose financial records are neither complex nor extensive, such disclosure is well tailored to providing fair-share feepayers with "sufficient information to gauge the propriety of the union's fee," 475 U.S. at 306, as *Hudson* requires.

II.

A. As noted above, the Third Circuit in this case and the Ninth Circuit in *Harik* reached diametrically opposed answers to the question of what *Hudson* requires of small local unions by way of disclosure.

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[2] While this statement of expenditures was not heretofore attested to by a local union officer under penalty of perjury, SAEA represented to the court below its intent to provide such sworn verification in future years.

Harik involved a teachers' union whose size and circumstances were substantially identical in all relevant respects to those of SAEA, and which attempted to satisfy its disclosure obligation under *Hudson* in much the same way as does SAEA—by providing feepayers with a sworn, but unaudited, statement of the major categories of its chargeable and nonchargeable expenditures, supplemented by an invitation to inspect the union's checkbook and cancelled checks. 326 F.3d at 1047.[3]

The Ninth Circuit held that audited financial statements were not required under these circumstances:

> For the smallest affiliates, providing financial reports along with full and fair access to bills, check stubs, canceled checks, account balances, and related materials may be more cost-efficient than an external review; we need not dictate the particular procedure as long as it is sufficiently reliable to ensure that a nonmember can independently verify that the union spent its money where it claimed that it did.

Id. at 1049.

The Ninth Circuit's holding is squarely in conflict with the Third Circuit's holding in this case that, in order to comply with *Hudson*'s disclosure requirement, "local unions, regardless of their size, are required to obtain audits of their financial statements." App. 13a.

These two recent court of appeals decisions, decided on facts that cannot be distinguished in any meaningful way,

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[3] While the Ninth Circuit's opinion does not provide specific information about Dinuba Teachers Association ("DTA"), the record in that case reveals that during the relevant school year DTA had 231 members and revenue of about $29,000, that it employed no professional staff, that it collected just over $600 in agency fees from its seven nonmembers, and that the cost of an audit would have been $2,800. Supplemental Excerpts of Record 109, 134-36, 173, Case No. 01-15590 (9th Cir.).

thus present an irreconcilable conflict with respect to the application of *Hudson*'s disclosure requirement to small local unions.

B. Two state appellate courts, both applying federal law, have also addressed the question whether small local unions can meet *Hudson*'s requirements by providing feepayers with complete, albeit unaudited, disclosure of the expenditures that constitute the basis for the union's fair-share fee. Like the Ninth and Third Circuits, these state courts are equally divided on the question.

In line with the Third Circuit, the Massachusetts Supreme Judicial Court has answered the question in the negative, holding flatly that a small local union "must accompany any demand for agency fees with an independently audited verification of its major expenses." *Wareham Educ. Ass'n v. Labor Relations Comm'n*, 713 N.E.2d 363, 368 (Mass. 1999). Like the Third Circuit, the Massachusetts court concluded that *Hudson*'s reference to verification by an independent auditor controlled and that any other form of disclosure was insufficient. *Id.* at 367-68.

The Massachusetts court reached that conclusion in a case involving three local unions that represented bargaining units ranging from 116 to 205 employees, with annual expenditures of between $9,400 and $29,000. The one to seven non-members in those bargaining units were charged agency fees of no more than $45. *Id.* at 365. The unions provided their feepayers with breakdowns of their major categories of chargeable and nonchargeable expenditures, sworn to under penalty of perjury, and they offered the feepayers in addition the opportunity either to obtain an itemized listing of all of their local's expenditures or to examine personally the union's expenditure records. *See id.* at 364-65; *Wareham Educ. Ass'n*, 24 Mass. Labor Cases 23 (Mass. Labor Rel. Comm'n 1997). The Massachusetts court rejected that form of disclosure as inconsistent with *Hudson*, requiring the

unions instead, as a condition for continuing to collect agency fees, to obtain audited statements of their expenditures—at a projected cost for each local of between $2,200 and $4,100. 713 N.E.2d at 366.

The Indiana Court of Appeals reached the opposite conclusion, holding—in a case involving a small local union with an annual budget of under $3,500—that audited financial statements were not required under the circumstances. *Whitley County Teachers Ass'n v. Bauer*, 718 N.E.2d 1181, 1191-92 (Ind. Ct. App. 1999). The court explained that *Hudson*'s reference to "verification by an independent auditor" was "justified in that case 'by that particular union's size and the amount of money involved.'" *Id.* at 1192.

C. The Third Circuit's holding that that a small local union can never satisfy its *Hudson* disclosure obligation in any way other than through audited financial statements also conflicts with multiple decisions of other courts that have upheld, under *Hudson*, forms of local-union financial disclosure that did not include an independent audit of the local's expenditures.

Two well-reasoned decisions have accepted the use of a "local presumption," under which the local unions do not provide feepayers with any actual expenditure information—audited or not—and instead rely on an empirically supported presumption that the chargeable portion of their expenditures is greater than the chargeable portion of the parent union's expenditures (as shown on the parent union's audited financial statements).

The Wisconsin Supreme Court has approved the use of an empirically based local presumption in the public sector, holding that *Hudson* does not require an audit of every local union's expenditures. *Browne v. Wisconsin Employment Relations Comm'n*, 485 N.W.2d 376, 393-94 (Wis. 1992).

More recently, the D.C. Circuit upheld reliance on an empirically supported local presumption in the private sector, *Thomas v. NLRB*, 213 F.3d 651 (D.C. Cir. 2000), holding that "petitioners[']conten[tion] that the use of a local presumption can never be squared with *Hudson*" "rests on a reading of *Hudson that this circuit has rejected*." *Id.* at 659-60.[4]

The Seventh Circuit's decision in *International Ass'n of Machinists v. NLRB*, 133 F.3d 1012, 1016-18 (7th Cir. 1998)—which approved a system of financial disclosure under which the local unions' statements of expenditures were "audited" by lay employees of the parent union—also conflicts with the Third Circuit's holding that nothing other than an audit by an independent accountant can ever satisfy a union's disclosure requirement under *Hudson*.

While *Thomas* and *Machinists* were National Labor Relations Act cases, the courts focused their analysis on whether the challenged disclosure was in conformity with the *Hudson* requirements which—in both the D.C. Circuit and the Seventh Circuit—govern NLRA cases by analogy. *See Thomas*, 213 F.3d at 658 ("Although *Hudson* involved constitutional concerns, this court has applied the basic protections of *Hudson* to the *Beck*-defined DFR cases involving private sector employees."); *Machinists*, 133 F.3d at 1017 (while *Hudson* was a constitutional rather than a statutory case, "[i]t is not obvious why this should make a difference").

Browne, *Thomas*, and *Machinists* thus all stand for the proposition that *Hudson* does not invariably require small

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[4] By contrast, reliance on an *unsupported* local presumption has generally been held insufficient to meet *Hudson*'s disclosure requirements. *See Hohe v. Casey*, 956 F.2d 399, 410 (3d Cir. 1992); *Prescott v. County of El Dorado*, 177 F.3d 1102, 1108 (9th Cir. 1999), *vacated*, 528 U.S. 1111, *reinstated in pertinent part*, 204 F.3d 984 (9th Cir. 2000); *see also Lowary v. Lexington Local Bd. of Educ.*, 903 F.2d 422, 430-31 (6th Cir. 1990) (striking down a local presumption that went beyond an evidentiary assumption and purported to bind the independent arbitrator).

local unions to provide financial statements verified by an independent auditor as the only possible way of making adequate disclosure. They are, in short, irreconcilable with the Third Circuit's holding in this case, and that of the Massachusetts court in *Wareham*, that a local union, regardless of its size and circumstances, can only satisfy *Hudson*'s disclosure requirement through audited financial statements.

III.

What is particularly striking about the decision below—and the *Wareham* decision in Massachusetts—is the absence of any reasoned justification for an audit requirement that threatens to render collection of any fair-share fee prohibitively expensive for small locals like SAEA. In point of fact, what divides the lower courts is not any debate about what kind of financial disclosure requirement for small locals serves the overall agency fee procedural system set out in *Hudson*, but only disagreement about the extent to which the courts are bound by this Court's reference, in *Hudson*'s footnote 18, to "verification by an independent auditor."

The Ninth Circuit in *Harik* accepted the proposition that there could be more "cost-efficient" ways than an audit for small local unions to provide feepayers with proper information that would permit them to make an informed decision about whether to challenge the fair-share fee. 326 F.3d at 1049. Acknowledging that view, the Third Circuit implied its agreement: "Were we writing on a clean slate, we might well require something less rigorous for small local unions than independent auditor verification." App. 11a. But the Third Circuit believed its hands to be tied by *Hudson*:

> But the slate is not clean. We are bound by the Supreme Court's decision in *Hudson*, and its directive of "verification by an independent auditor" means just that. *Hudson* implied no intent to make the audit requirement

> depend on the size of the reporting union. Absent a counter directive by the Supreme Court, we likewise make no exception.

Id.

It is very much to the point that the Third Circuit did not offer any reason why providing audited financial statements was the only way in which a small local union like SAEA—a local with few members and limited expenditures—could give feepayers "sufficient information to gauge the propriety of the union's fee." *Hudson*, 475 U.S. at 306. The same is true of the *Wareham* decision that reached the same result. *See* 713 N.E.2d at 367-68. In both cases, the court's only justification for its holding was *Hudson*'s reference, 475 U.S. at 307 n.18, to "verification by an independent auditor."

Nor is any other rationale readily apparent. As we have noted, the Chicago Teachers Union—the union party in *Hudson*—had some 27,000 members, annual revenues exceeding $4.1 million, a substantial staff, a wide range of expenditures, and, of necessity, complex financial books and records. It is safe to assume that such an organization would routinely obtain an annual audit of its expenditures, and it is equally clear that a rank-and-file nonmember, even if given full access to the union's books, would be overwhelmed by the task of verifying that the union's statement of its "major categories of expenses" accurately captured its expenditures in each category. It was, therefore, unsurprising for the *Hudson* Court to opine that—in the context of a union of this size—"adequate disclosure surely would include the major categories of expenses, as well as verification by an independent auditor." 475 U.S. at 307 n.18.

But that does not mean that nothing short of audited financial statements can be adequate disclosure in the context of a small organization with no employees, a $22,000 annual budget, and a financial ledger recording its expenditures. As the Ninth Circuit held in *Harik*, a small local union can

provide feepayers with sufficient information to gauge the propriety of its fee *either* through audited financial statements *or* by giving its feepayers "the full financial material necessary to verify . . . the local union's chargeable and non-chargeable expenditures." 326 F.3d at 1049. Thus, as the *Harik* court put it, a small local's disclosure obligation could be met by "providing financial reports along with full and fair access to bills, check stubs, canceled checks, account balances, and related materials." *Id.*

This form of financial disclosure is eminently well suited to small local unions like SAEA, whose expenditures are sufficiently few in number that an interested feepayer can, in essence, be given the union's checkbook and allowed to see for herself what the union's money went for. SAEA's statement of its major categories of expenditures is compiled from materials that essentially speak for themselves, which local-union feepayers can understand. The relative simplicity and transparency of these financial records can afford feepayers a reasonable measure of assurance that the union's funds went for the purposes described in the union's statement of its major categories of expenditures.

Indeed, it is hardly too much to suggest that the typical feepayer, who may be unfamiliar with audited financial statements, may well derive a *better* understanding of the local union's expenditures from this kind of financial disclosure than from a formal auditor's report. *Cf. Gilpin v. AFSCME*, 875 F.2d 1310, 1316 (7th Cir. 1989) (suggesting that an agency fee notice "as long and complicated as an SEC prospectus" does not necessarily serve the interests of feepayers).

The recognition that alternative forms of verification can be appropriate in the case of small organizations is hardly a novel one. It is, in fact, commonplace for governmental audit requirements to be waived or relaxed for smaller entities, where the cost of an audit is often disproportionate to what is

at stake.[5] It may be the case, as the Third Circuit observed, that "an audit 'make[s] assurance double sure,'" App. 13a (quoting Shakespeare), but to apply that principle blindly without regard to the balance between the additional cost of such a requirement and the additional value, if any, to be gained from that requirement makes little sense. *Cf. Mathews v. Eldridge*, 424 U.S. 319, 335 (1976) (looking, in the due process context, to "the probable value, if any, of additional or substitute procedural safeguards").

As the Financial Accounting Standards Board has explained in its Statements of Financial Accounting Concepts, "[t]here are usually alternative ways of handling an issue," and it is fully appropriate to consider whether "one of them [is] less costly and only slightly less effective." Financial Accounting Standards Board, *Statements of Financial Accounting Concepts* 83 (2002) (Statement of Financial Accounting Concepts No. 2, ¶ 143). Thus, "[i]n order to justify requiring a particular disclosure, the perceived benefits to be derived from that disclosure must exceed the perceived costs associated with it." *Id.* at 32.

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[5] For example, federal regulations requiring audits of nonprofit recipients of federal funds exempt from that requirement entities that expend less than $300,000 a year in federal awards. Audits of States, Local Governments, and Non-Profit Organizations, 62 Fed. Reg. 35278, 35291 (June 30, 1997). Similar examples culled from Pennsylvania law include the following: 10 Pa. Stat. Ann. § 162.5(f) (exempting from audit requirement charitable organizations receiving contributions of less than $50,000, and allowing "review" instead of audit for those with contributions of less than $125,000); 15 Pa. Cons. Stat. § 7536(b) (allowing audits of agricultural cooperatives with sales of less than $100,000 to be performed by non-CPA members of the association); 20 Pa. Cons. Stat. § 3531 (allowing distribution of decedents' estates of less than $25,000 without formal proceedings including audit); 66 Pa. Cons. Stat. § 516(a) (requiring audits of utilities, but only if plant value exceeds $10 million); 68 Pa. Cons. Stat. § 3320(9) (allowing declarant's warranty rather than audit of condominium associations of less than 12 units).

Consideration of the relative costs and benefits of alternative forms of financial disclosure in these circumstances is particularly appropriate in view of the limited purpose of the financial disclosure *Hudson* requires. Disclosure of the union's major categories of expenditures is not a matter of proving the union's entitlement to the fee it seeks. That step comes later, when—if any feepayer challenges the fee—the union is required to prove to an independent decisionmaker its entitlement to the amount of the fee it has assessed. *See Hudson*, 475 U.S. at 307-08. The purpose of the disclosure requirement is simply to enable the feepayer to make an informed decision about whether to accept the union's calculation of its fair-share fee or exercise her right to challenge the fee before an independent decisionmaker. *See Wareham*, 713 N.E.2d at 368; *Dashiell v. Montgomery County*, 925 F.2d 750, 756 (4th Cir. 1991).

The feepayer deciding whether to take the step of challenging the fee is contemplating an act that—in contrast to many other endeavors undertaken in reliance on audited financial statements—is virtually cost-free and risk-free: if in doubt, the feepayer need only file her challenge, which costs nothing but a 37-cent stamp. As the Seventh Circuit has noted, "mounting a challenge is for all practical intents and purposes free." *Gilpin*, 875 F.2d at 1316.[6] The suggestion that feepayers of a small local union like SAEA can *only* be given sufficient information for that purpose through audited financial statements is inconsistent with the limited purpose of the disclosure requirement.

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[6] By filing a challenge, the feepayer becomes a party to the annual *Hudson* arbitration of fair-share fee challenges. While the arbitrator's decision is binding on the union, it does not preclude the feepayer from challenging the fair-share fee on a *de novo* basis in court. *Hudson*, 475 U.S. at 308 n.21; *Bromley v. Michigan Educ. Ass'n*, 82 F.3d 686, 691-95 (6th Cir. 1996). Thus, filing a challenge to the fair-share fee neither costs the feepayer anything nor has any adverse effect on her litigation options.

It is also inconsistent with the emphasis in this Court's agency fee cases on striking a balance between the competing interests involved. *Abood*, 431 U.S. at 237, *Hudson*, 475 U.S. at 302. Reading *Hudson*'s dicta as invariably requiring audited financial statements even in the case of the smallest local unions is not only unnecessary to protect the interests of feepayers; it would impose heavy transaction costs on small locals with limited resources.

The difficulty is readily apparent on the stipulated facts of this case, where the cost to SAEA of obtaining an audit would be more than twice the amount of the total fair-share fees SAEA could collect from its 11 nonmembers. It should not be surprising, therefore, that as a result of the district court's injunction, affirmed by the Third Circuit, SAEA and almost all of its sister locals in Pennsylvania have been obliged to forgo their statutory and contractual right to collect fair-share fees from the nonmembers they represent—contrary to this Court's stated goal of protecting the interests of feepayers "without restricting the Union's ability to require every employee to contribute to the cost of collective-bargaining activities." *Hudson*, 475 U.S. at 302.

A small local union like SAEA can, in short, meet *Hudson*'s disclosure requirement in ways that are more "cost-efficient than an external review." *Harik*, 326 F.3d at 1049. For such a union, requiring an audit by an independent accountant serves only to drive up the union's transaction costs to the point at which collecting any fair-share fee becomes prohibitively expensive. Courts that have nonetheless required such an audit—the Third Circuit in this case, and the Massachusetts Supreme Judicial Court in *Wareham*—have cited no reason for doing so other than their reading of *Hudson*. It is important, therefore, that the Court revisit this issue and clarify the disclosure requirement it articulated in *Hudson*.

IV.

As noted above, literally thousands of small local unions are seriously impacted by the decision of the Court below—either because they are directly bound by the Third Circuit's decision, or because of the chilling effect that flows from the legal uncertainty engendered by the conflicting decisions of the Third and Ninth Circuits. It is urgent that this Court resolve that legal uncertainty by granting review to clarify *Hudson*'s disclosure requirement as applied to small local unions like SAEA.

This case is a fully appropriate vehicle for that review. The facts are undisputed, indeed stipulated; the legal issue is squarely presented; no jurisdictional problem or extraneous legal issue would prevent the Court from reaching this issue; and counsel on both sides are highly experienced in the law of agency fee and have litigated the issue presented here in multiple cases. The issue has been fully ventilated in the lower courts, and this Court should now decide it.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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